(3)

No. 85-568

In the Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
ET AL., APPELLANTS

v.

UTILITIES COMMISSION OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING APPELLANTS

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

3210

QUESTIONS PRESENTED

Under the Federal Power Act, 16 U.S.C. 791a *et seq.*, the Federal Energy Regulatory Commission has sole authority over transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce. The questions presented are:

1. Whether the North Carolina Utilities Commission acted in contravention of established preemption doctrine in failing to give effect in calculating the retail rates for local end-users in North Carolina to the costs and allocations contained in the federally regulated interstate wholesale transactions that preceded the final retail sale.

2. Whether the North Carolina Utilities Commission rate order at issue in this case is also invalid under the Commerce Clause because of the economic preferences it grants local consumers at the expense of interstate markets.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Cases—Continued: Page

Cases—Continued: Page

Constitution and statutes:

In the Supreme Court of the United States

OCTOBER TERM, 1985

No. 85-568

NANTAHALA POWER AND LIGHT COMPANY, ET AL., APPELLANTS

v.

UTILITIES COMMISSION OF NORTH CAROLINA, ET AL.

ON APPEAL FROM THE SUPREME COURT OF NORTH CAROLINA

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING APPELLANTS

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Congress has charged the Federal Energy Regulatory Commission with the responsibility for administering the Federal Power Act, 16 U.S.C. 791a *et seq.*, including those provisions governing rates and charges for electric energy at wholesale in interstate commerce. 16 U.S.C. 824d, 824e. Accordingly, under the Federal Power Act, while the Commission does not

regulate retail rates to consumers, it does have exclusive authority to decide whether bulk wholesale power arrangements between utilities are just and reasonable. The North Carolina Utility Commission's reallocation of less expensive power between two utilities in this case, in order to reduce retail utility rates to North Carolina consumers at the expense of a customer in Tennessee, is inconsistent with the Commission's exercise of responsibility over such bulk power arrangements, and upsets the system that Congress established for regulation of electric rates in interstate commerce.

STATEMENT

A. Background And The Relevant Agreements.

As originally established, electric utilities tended to be local and self contained, and many still generate power through their own facilities. Nevertheless, today interconnections between different utilities permit the ready movement of bulk power from one part of the country to another over vast interstate grids. This national system encompasses a wide variety of formal interstate arrangements. Many of these arrangements are between independent companies, but frequently—as in this case—several companies operating under a common ownership participate with others in the arrangements for the interstate transfers of bulk power. See generally J. Pfeffer & W. Lindsay, The National Regulatory Research Institute, Ohio State University, *The Narragansett Doctrine: An Emerging Issue in Federal-State Electricity Regulation*, Occasional Paper No. 8 (Dec. 1984).

Nantahala Power and Light Company, an electric utility serving the public in North Carolina, is owned by Aluminum Company of America (Alcoa). Alcoa

also owns Tapoco, Inc., which exclusively serves Alcoa's aluminum operations in eastern Tennessee. Both operating companies own hydroelectric facilities along the Little Tennessee River, built many years ago with Alcoa financing and licensed by the Commission under Part I of the Federal Power Act (16 U.S.C. 797(e)). J.S. App. 18a-19a.

In the midst of these facilities is the large Fontana hydroelectric plant, built by the Tennessee Valley Authority in the early 1940s.[1] From the construction of Fontana until after the events relevant to this case, with very minor exceptions TVA directed the operation of all these facilities.[2] J.S. App. 19a-29a. During the relevant time period, TVA's operation of the facilities was pursuant to the New Fontana Agreement (NFA), signed in 1962, among TVA and Nantahala-Tapoco-Alcoa (J.S. App. 28a). That agreement provided that TVA would direct operations of Nantahala's and Tapoco's hydroelectric plants and take all the energy generated from them, which would vary according to stream flow conditions (J.S. App. 28a-29a, 286a). In return, certain specific entitlements to energy and power—but less than the total power generated by the Nantahala and Tapoco plants and taken by the TVA—were to be supplied to Nantahala and Tapoco-Alcoa by TVA (*ibid.*). The NFA itself, however, did not detail how much of these entitlements would go to each; these matters were spelled out in separate agreements. For purposes of this case, the relevant document is the 1971 Apportion-

---

[1] While Fontana and the Nantahala hydroelectric facilities are in North Carolina, the Tapoco facilities are in both North Carolina and Tennessee (J.S. App. 18a-19a).

[2] This permitted the most efficient operation of the total complex.

ment Agreement between Nantahala and Tapoco. J.S. App. 30a-31a, 286a-287a.

Both Nantahala and Alcoa bought power from TVA to meet their needs beyond the amounts they received as entitlements from TVA under the NFA, as provided for in the 1971 Apportionment Agreement (J.S. App. 287a).[3] However, this power purchased from TVA was more expensive—it cost about three times as much as entitlement power. Thus, the entitlement power received under the NFA, with costs based on the cost of running the Nantahala and Tapoco generating units, was less than 6 mils per kilowatt hour (kwh) (J.S. 6); the cost of power purchased from TVA with its higher expenses averaged about 19½ mils per kwh. J.S. App. 287a.[4]

B. The Decision Of The Commission.

In 1976 and 1978, the Commission[5] initiated proceedings based on a Nantahala rate filing and a complaint filed by one of its customers (J.S. App. 269a-270a). In that proceeding, the Commission examined the NFA and the 1971 Apportionment Agreement, which were filed as rate schedules. J.S. App. 283a-289a. After thorough consideration of these agree-

[3] Alcoa, unlike Nantahala's customers, made its own power purchasing arrangements directly with TVA (J.S. App. 66a).

[4] Nantahala's and Tapoco's generation is all old, low cost hydropower; TVA, as hydro sources were exhausted, has more recently had to add considerable capacity from more costly, nonhydro sources, and distribute these costs to its customers. J.S. App. 32a n.11.

[5] The term "Commission" herein refers to the Federal Power Commission prior to October 1, 1977, and to the Federal Energy Regulatory Commission thereafter. See 42 U.S.C. 7172(a), 7295.

ments and the claims of the parties, the Commission held that the NFA was "the result of arms' length bargaining" (J.S. App. 293a) and that it "indicates no intent on the part of any of the parties to ignore the needs of Nantahala's public service customers or deprive them of energy at just and reasonable rates." J.S. App. 295a. The Commission did decide, however, that adjustments were required in the 1971 Apportionment Agreement to give a somewhat bigger share of the entitlements from TVA to Nantahala, and decided how much that greater share would be. J.S. App. 295a-298a.

Based on that readjustment, the Commission established the rates that Nantahala could collect from its three wholesale customers in North Carolina. Once the division of entitlements was established, it followed that the remaining volumes of power required would be purchased from TVA under the contractually established rates. Rates to Nantahala's wholesale customers thus reflect the respective costs of its entitlements and its purchased power. J.S. App. 298a, 301a.[6]

Following appeals by Nantahala, by some of its customers and by the Attorney General of North Carolina, the court of appeals affirmed the Commission's decision in all respects. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

C. The Ruling Of The North Carolina Commission And The State Supreme Court.

The North Carolina Utilities Commission (NCUC) in its review of retail rates charged by Nantahala re-

[6] The Commission noted that "[t]he effect of this opinion is to provide entitlements to Nantahala which will result in just and reasonable rates to its wholesale customers" (J.S. App. 298a).

jected the NFA on the basis that it was unfair to Nantahala and did not result in just and reasonable rates (J.S. App. 15a, 32a, 70a-71a). It substituted an approach proposed by Nantahala's customers,[7] which would give Nantahala, and consequently the North Carolina retail customers, a larger share of the low cost entitlement power, and correspondingly reduce their need for more expensive purchases. Specifically, NCUC first calculated the available energy, which it defined to include the total energy available to TVA from the Nantahala and Tapoco facilities, rather than the smaller volumes of entitlements which Nantahala and Tapoco actually received from TVA for delivery to their customers (J.S. App. 68a-69a). NCUC then added to this figure the amount of power Nantahala bought from TVA and delivered to its customers; it did not include Alcoa's TVA purchases (*ibid.*). NCUC defined this overall amount as the "pool" of power. It next calculated how much power Nantahala needed to serve its customers, which amounted to about 25% of the pool (*ibid.*). NCUC then totalled the costs associated with generating power from both the Nantahala and Tapoco facilities and the cost of Nantahala's purchased power (but not Alcoa's). It applied the 25% figure to that amount to derive what Nantahala would be allowed to collect from its North Carolina retail rate payers.

This method of calculation resulted in a shift of more low cost power to Nantahala for its customer load than the FERC had allocated in its proceeding. As NCUC recognized, its method gave Nantahala "first call" on the electric energy output deemed available (J.S. App. 183a). This approach necessarily meant that while Nantahala's customers got an allocation based on their needs, Alcoa (Tapoco's customer) was left with only whatever residual low cost power remained after both Nantahala and TVA had taken their supplies of "available" power. At the same time, Alcoa was made responsible for the costs not only of all of its own TVA purchases, but 75% of Nantahala's as well (J.S. App. 69a-70a). Alcoa's share of the costs was further swollen by amounts attributable to the power that went to TVA and was not reflected in entitlements received in return. As the result of these NCUC rulings, the end users served by Nantahala received a substantial reduction in their retail rates.

[7] FERC had earlier rejected that approach when proposed by the wholesale customers (J.S. App. 288a-298a).

While the North Carolina Supreme Court recognized that NCUC's rulings raised "substantial questions under the federal constitution" concerning preemption and interference with interstate commerce (J.S. App. 12a-13a), it concluded that there was no constitutional infirmity and affirmed NCUC in all relevant respects (J.S. App. 12a, 72a-106a).

INTRODUCTION AND SUMMARY OF ARGUMENT

This case involves a classic dispute over the allocation of limited amounts of inexpensive power, and the costs associated with it, between customers of different companies in different states. A state, of course, has a legitimate interest in reducing the cost to its citizens of electric power, but its authority to effectuate that reduction is not unbounded; there are constitutional limitations that must be observed. As this Court recently explained in *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 377 (1983) (citations omitted):

> Maintaining the proper balance between federal and state authority in the regulation of electric and other energy utilities has long been a serious challenge to both judicial and congressional wisdom. On the one hand, the regulation of utilities is one of the most important of the functions traditionally associated with the police power of the States. * * * On the other hand, the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by the States can patently interfere with broader national interests.

In this case there is a finite amount of cheap power and a pool of costs that must be absorbed by someone. The approach employed by NCUC would benefit the Nantahala customers in North Carolina by giving them more of the low cost entitlement power, and permitting them to absorb less of the overall costs associated with that power. However, it would have the concomitant effect of forcing additional costs on the other customer, Alcoa, located in Tennessee. This is precisely the type of dispute which should be resolved in a federal forum.

I. Under the Federal Power Act, Congress has established a federal regulatory authority to deal with what has long been properly viewed as a matter of inherently interstate concern—*i.e.*, the bulk power arrangements between utilities that have become so important in the electric utility industry. The Commission is empowered to review and, in appropriate circumstances, modify these arrangements. Although Congress explicitly provided a role for states and state utility commissions in the federal process, there can be no overlapping decisional authority. It is fun-

damentally at odds with the scheme Congress has established in the Power Act to permit state authorities to change the arrangements filed with or established by FERC in order to make them more favorable to their own citizens at the expense of operations in other states. Indeed, to allow such state determinations would be particularly inappropriate in the present context, because NCUC has sought to change the precise allocations established by the Commission in the course of its review of the interstate arrangements.

II. Viewed from a slightly different perspective, the North Carolina action here also violates the Commerce Clause because, like the situation reviewed by this Court in *New England Power Co.* v. *New Hampshire*, 455 U.S. 331 (1982), the state's reallocation of the economic benefits resulting from the NFA parties' agreement constitutes impermissible protectionist regulation.

ARGUMENT

I. THE STATE'S ACTION HERE IS PREEMPTED BY THE FEDERAL POWER ACT

A. The Federal Commission's Authority To Establish Wholesale Rates Is Comprehensive.

In a series of cases from 1919 to 1927, this Court fashioned a constitutional line of demarcation between permissible and impermissible state regulation, holding that the Commerce Clause permitted the states to regulate retail sales but not wholesale sales in interstate commerce. If a utility sold to consumers and at the same time engaged in power transactions with other utilities, the state could regulate the former but not the latter. The reasoning was that:

> [T]he supplying of local consumers being "a local business," even though the gas be brought from another State, in which the local interest is paramount and the interference with interstate commerce, if any, indirect and of minor importance; but that in the sale of gas in wholesale quantities, not to consumers, but to distributing companies for resale to consumers, where the transportation, sale and delivery constitutes an unbroken chain, fundamentally interstate from beginning to end, "the paramount interest is not local but national, admitting of and requiring uniformity of regulation," which, "even though it be the uniformity of governmental nonaction, may be highly necessary to preserve equality of opportunity and treatment among the various communities and States concerned."

Public Utilities Commission v. *Attleboro Steam & Electric Co.*, 273 U.S. 83, 89 (1927) (quoting *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298, 309-310 (1924)).

With the enactment of the Federal Power Act in 1935, Congress created a scheme of federal regulation under which the previously established commerce clause criteria were effectively subsumed by statutory preemption of the entire wholesale electric area. See, *e.g.*, *New England Power Co.*, 455 U.S. at 340: *Maryland* v. *Louisiana*, 451 U.S. 725, 750-751 (1981); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 381. The federal scheme leaves no room either for direct state regulation of wholesale prices, or for state regulations that indirectly have the same result. *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84, 91 (1963).

In the Federal Power Act, Congress has established a comprehensive federal regulatory scheme to deal

with sensitive issues of apportionment of rights and obligations among interests in different states.[8] Unquestionably, a prime purpose of the Federal Power Act, like state regulatory laws, is to protect customers against overreaching by electric utilities. See *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 758 (1973). But the federal statute also reflects the judgment, embodied in the Commerce Clause, that there are situations where the broader perspective of the federal authority is necessary. Cf. *Edgar* v. *Mite Corp.*, 457 U.S. 624, 644 (1982).

The federal regulatory scheme recognizes the legitimacy of state interests in this area, and provides for the consideration of those interests in the Commission regulatory process. States and state commissions may file complaints about activities of licensees and public utilities subject to the Commission's jurisdiction (16 U.S.C. 825e) and their objections may ultimately result in Commission action declaring rates, practices and contracts unjust and unreasonable and establishing new ones (16 U.S.C. 824e(a), 824d(e)). The states may also seek review of Commission orders in the federal courts (16 U.S.C. 825*l*(b)). There is

---

[8] This case obviously involves such interests. On one side is North Carolina, which has decided that it should have a larger share of the low cost entitlement power for its consuming public. On the other side are the Tennessee interests —Alcoa, which is the Tennessee customer, supported in this Court by the State of Tennessee and by the United Steelworkers Union representing Alcoa's Tennessee employees. In addition, this Court has granted the Edison Electric Institute's motion to file a brief amicus curiae to explain the impact of the decision below on the interests of its members, investor-owned electric utility companies. This Court has long recognized that investors have a protectible interest in the establishment of just and reasonable rates. See note 11, *infra*.

no room in this scheme, however, for the states or state commissions to act inconsistently with Commission determinations with which they are dissatisfied.

In recognition of this comprehensive federal regulatory authority over wholesale rates, it is specifically settled that a rate filed with the Commission and within its jurisdiction, although subject to judicial review, cannot thereafter be challenged in another forum; only the Commission is empowered to order it changed. *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246, 251-252 (1951). The "filed rate" is reasonable as a matter of law and any effort by a state to disregard or reject it is impermissible. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 581-582 (1981). State courts have consistently affirmed that state regulatory commissions are prohibited from reevaluating the wholesale rates fixed by FERC and disallowing, for retail ratemaking purposes, those that the state commission finds to be unreasonable.[9]

[9] *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978), is generally considered the leading case, although it in turn relied on earlier decisions in *City of Chicago* v. *Illinois Commerce Commission*, 13 Ill. 2d 607, 616, 150 N.E.2d 776, 780-781 (1958); *United Gas Corp.* v. *Mississippi Public Service Commission*, 240 Miss. 405, 442-444, 127 So. 2d 404, 420-421 (1961); and *Citizen Gas Users Association* v. *Public Utilities Commission*, 165 Ohio St. 536, 538, 138 N.E.2d 383, 384 (1956).

Numerous other courts have followed *Narragansett*. *E.g.*, *Eastern Edison Co.* v. *Department of Public Utilities*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Office of the Public Counsellor* v. *Indiana & Michigan Electric Co.*, 416 N.E.2d 161, 164-165 (Ind. App. 1981); *Public Service Co.* v. *Public Utilities Commission*, 644 P.2d 933, 936-940 (Colo. 1982); *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985); *Spence* v. *Smyth*, 686 P.2d 597 (Wyo. 1984); *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375, 384-386 (D.C. App. 1982), cert. denied, 462 U.S. 1107 (1983).

B. The State Cannot Validly Establish Retail Rates That Fail To Give Effect To Wholesale Costs Approved By The Commission.

While the North Carolina Supreme Court did not expressly reject the "filed rate" doctrine, in fact it ignored the Commission's filed rate as established in the wholesale rate proceeding. Thus, while the state court recognized that the Commission has exclusive jurisdiction over the wholesale power transactions and agreements among Nantahala, Tapoco, Alcoa and TVA (J.S. App. 72a), that court nonetheless substantially revamped those arrangements to suit parochial state interests.

To be sure, the North Carolina court has not in terms rejected any wholesale rates or modified any agreements filed with FERC (J.S. App. 76a). But what it has done amounts functionally to the same thing: It has affirmed the NCUC's disregard of FERC's allocations of the low cost power in favor of an allocation more favorable to local customers. The state decision thus approves precisely the intrusion into the federal regulatory jurisdiction that the Federal Power Act prohibits.

1. The court below unsuccessfully attempted to distinguish the case law applying the "filed rate" doctrine (see note 9, *supra*). *Narragansett Electric Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), cert. denied, 435 U.S. 972 (1978), involved the cost of power that Narranganssett, a utility which served Rhode Island, brought from New England

Power Company, an affiliate serving Massachusetts. Since that was a wholesale transaction, the Commission regulated the rate, but the Rhode Island Public Utilities Commission (PUC) ruled that it could nevertheless prevent Narragansett from passing through to its customers any portion of that rate that the PUC found "strikingly" or "glaringly" unreasonable (119 R.I. at 563-564, 381 A.2d at 1361).

Relying upon the "filed rate" doctrine as developed by this Court in *Montana-Dakota*, 341 U.S. at 251-252, the Rhode Island Supreme Court held that the Federal Power Act had preempted the authority of PUC to investigate interstate prices. It found that the determination as to overreaching was exclusively for the federal commission to make, and if overreaching was found, it was exclusively up to the federal commission to make the necessary adjustments to remedy the situation. In short, the state court held that the wholesale rate fixed by the federal commission constituted an operating expense of Narragansett and must be so viewed by PUC. 119 R.I. at 566-567. 381 A.2d at 1362. Thus, while FERC does not establish retail rates, it does establish the reasonableness of purchased power costs.

Of course, purchased power costs are not the only costs an electric utility incurs. The *Narragansett* court accordingly noted that the state did not necessarily have to recognize changes in purchased power costs through a purchased power adjustment clause that provided for automatic rate increases or decreases based on changes in that one element, regardless of what was happening in other cost areas. Instead, *Narragansett* permitted PUC to consider changes in a general rate proceeding where all costs would be evaluated together. 119 R.I. at 568, 381

A.2d at 1363. What *Narragansett* does require, however, is that a utility's wholesale power costs (*i.e.*, "the filed rate") be recognized as "just and reasonable" operating expenses in the state retail ratemaking proceeding.[10] As the opinion summarized (*ibid.* (emphasis added: citation omitted)):

> The manner in which a fuel adjustment clause is treated is an administrative matter where there is broad latitude for the exercise of sound discretion. Therefore, we do not order the PUC to automatically adjust the retail rates in accordance with the purchased power cost adjustment clause. Rather, we remand the case to the PUC with the direction that no matter what method it adopts in considering Narragansett's proposed rate increase, *it must treat the* [*FERC*] *filed* [*rate*] * * * *as an actual operating expense.*

Similarly unfounded is the reliance of the court below (J.S. App. 83a-84a) on isolated language in a footnote in *Washington Gas Light Co.* v. *Public Service Commission*, 452 A.2d 375, 385 n.15 (D.C. App. 1982), suggesting that "determination of the extent to which wholesale costs shall be reflected in utility rates lies exclusively with local utility commissions." Since in the related text the *Washington Gas Light* court strongly reaffirms the *Narragansett* holding that "State and local commissions have no authority, therefore, to inquire into the reasonableness of wholesale rates, but *must allow them as reasonable operating expenses*" (452 A.2d at 385-386 (emphasis added)), the footnote statement cannot have the

---

[10] *Public Service Co.*, note 9, *supra*, similarly deals with the mechanics of the cost passthrough; it does not question the recovery of federally regulated rates as part of the expenses of a buying company.

broad meaning the court below attributed to it. Instead, it merely recognizes, as we explained above, that *Narragansett* does not require the automatic passthrough of all changes in wholesale rates without consideration of changes in other operating costs.[11]

2. The proper interplay of federal and state regulatory authority here is well illustrated by a recent series of cases involving Northern States Power. The *Narragansett* line of cases involves the first step in establishing utility rates—the calculation of the revenue requirement, or the money needed to recover reasonable expenses and capital costs. In contrast, this case, *Northern States Power Co.* v. *Minnesota Public Utilities Commission*, 344 N.W.2d 374 (Minn. 1984), cert. denied, No. 83-1752 (June 18, 1984), and *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981), involve the second step in the process of establishing rates—designing rates so that revenues sufficient to meet the revenue requirement will be recovered from the totality of the customers served. At this stage, the question is not whether to disallow costs, but whether to assign them to another customer.

[11] *Narragansett* also recognized (119 R.I. at 568, 381 A.2d at 1363) that the failure to treat filed costs as operating expenses might result in confiscation of the utility's property. This Court has explained that no regulatory commission can set rates at a level that prevents the utility from recovering its reasonable operating expenses. Investors are entitled to demand rates sufficient to cover expenses and capital costs of the business, including a return to shareholders commensurate with returns on other businesses with similar risks. *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Cf. *Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U.S. 276, 289 (1923); *Bluefield Water Works* v. *Public Service Commission*, 262 U.S. 679, 690 (1923). This case does not, of course, involve any direct attempt by a local commission to establish confiscatory rates. NCUC does not want to disallow the costs at issue here, it simply wants to shift them to the out-of-state customer of the other utility (J.S. App. 86a). The effect, however, may be the same. See pages 18-19, *infra*.

Preemption principles must be considered at this stage too, as the *Northern States Power* cases demonstrate. Northern States Power has one company serving customers in Minnesota and the Dakotas and another serving those in Wisconsin. An interstate wholesale arrangement between the two companies provided that they would share all capacity and all costs, pursuant to a formula set forth in the Coordinating Agreement between them that was filed with the Commission. When shrinking demand projections for the system led to a decision to cancel a major facility that was to be located in Wisconsin and owned by the Wisconsin company, utility commissions in the other states objected to sharing in the costs caused by the cancellation, arguing that those costs should be born solely by the Wisconsin company. The FERC upheld application of the Coordinating Agreement to the situation (see *South Dakota Public Utilities Comm'n* v. *FERC*, 690 F.2d 674 (8th Cir. 1982)) and the Supreme Courts of Minnesota (*Northern States Power Co.* v. *Minnesota Public Utilities Commission*, *supra*) and North Dakota (*Northern States Power Co.* v. *Hagen*, *supra*) reversed the state utility commission determinations that the costs could not be reflected in their local retail rates.

Both state courts recognized (314 N.W. 2d at 35-38, 344 N.W. 2d at 381-382 n.17) that the *Narragansett* principle applied in this context as well; FERC's approval of the application of the Coordinating Agreement to this situation established the wholesale rate, and "the state utilities commission

is required to treat the allocated abandonment costs as expenses for power purchased in determining the retail rates" (344 N.W.2d at 382; accord, 314 N.W. 2d at 38). These rulings are entirely correct, and the same principle also governs here. If each state could decide for itself whether to follow the federal allocation decision, each would be likely to adopt the approach that would minimize the costs assigned to its own ratepayers—as NCUC did here. While each approach might, if considered in isolation, be reasonable, the result for utilities operating interstate and their investors would be a shortfall of unrecovered costs, due to the application of inconsistent approaches, each designed to minimize costs to a particular group. The very real possibility of such inconsistent regulatory determinations, threatening to leave extensive gaps of this sort, has led utilities to seek a single forum.[12] When operations are interstate

[12] Some inconsistencies are tolerated in the federal-state regulatory system established under the Federal Power Act. For example, in this case NCUC regulates Nantahala's rates for the part of its power that goes directly to North Carolina retail customers, while the Commission regulates the rates for the power sold to North Carolina wholesale customers. The two authorities may make different judgments about how the utility's costs (upon which rates are based) should be allocated between these two groups, which could leave Nantahala with either a revenue gap or an overcollection. Minor inconsistencies of this sort, involving the allocation of the costs of a single company among the customers of that company, are not likely, however, to have serious practical effects. This case, in contrast, involves a very different situation: it concerns the costs of the bulk power transactions upon which the company relies to obtain the power it sells to its customers, and the state's attempt to allocate a substantial part of those costs, not to other customers of that utility, but to customers of a separate entity. This attempt cannot prevail against the Commission's exclusive jurisdiction over the bulk power transactions involved; the Commission approved costs arising from these transactions must be recognized by state ratemaking authorities. In their Motion to Dismiss or Affirm (at 15-16), appellees rely on a casual remark of the Commission (J.S. App. 305a) that may have failed adequately to distinguish the separate considerations involved in these two types of situations.

in nature, the federal forum is provided by the Federal Power Act.[13]

3. The court below invokes another line of state court cases, permitting state commissions to inquire into available alternative power sources (J.S. App. 84a). See *Pike County Light & Power Co.* v. *Pennsylvania Public Utility Commission*, 77 Pa. Commonw. 268, 465 A.2d 735 (1983); *Appeal of Sinclair Machine Products, Inc.*, 498 A.2d 696 (N.H. 1985). But those cases simply stand for the proposition that

[13] A company with large retail operations in several states may minimize the effects of inconsistent state regulation by establishing a separate corporate entity in each state. But by doing this, the company subjects itself to the FERC ratemaking authority, to the extent there are power arrangements between them, rather than within a single corporation. The state cannot, as NCUC attempted here, extend its control into the interstate area by the "roll-in" expedient—*i.e.*, treating the local utility and a distinct out-of-state entity as a single unit for cost and ratemaking purposes. The state is inconsistently attempting both to create an interstate entity for purposes of establishing costs, and denying its interstate character for purposes of asserting its ratemaking authority. But North Carolina's attempt is equivalent to creating an inter-utility bulk power transaction, to obtain Tapoco's power for Nantahala and its North Carolina customers. This the state utility commission is forbidden to do, both by the Federal Power Act and this Court's pre-Act Commerce Clause cases. See pages 9-10, *supra*.

where the FERC has approved a wholesale rate for purchased power as just and reasonable, the state regulatory body still has the authority to determine whether the purchaser was acting in a prudent manner in entering into a contract to purchase the power at that rate, instead of seeking to buy less expensive power elsewhere.

This case involves no *Pike County* situation.[14] The alternative bulk power supply that North Carolina consumers covet—*i.e.*, the low cost entitlement power that Tapoco gets from TVA in exchange for the power generated at Tapoco facilities—is not available to Nantahala It is being sold to Alcoa to meet the needs of Alcoa's Tennessee operations. North Carolina's assertion of a right to this power for its consumers is based on its finding that there was overreaching by Alcoa in the negotiation of the TVA-Nantahala-Tapoco arrangement (J.S. App. 89a), but the Commission has already corrected for that overreaching by taking away some entitlements from Tapoco-Alcoa and awarding them to Nantahala and its customers (page 5, *supra*). NCUC and the court below simply decided that further corrections would be appropriate. At that point, the decisions of the state authorities became inconsistent with FERC's decision; when that happens, state regulation must give way to federal. *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 141-142 (1963); *Northern Natural Gas Co.*, 372 U.S. at 92; *Arkansas Electric Cooperative Corp.*, 461 U.S. at 383-384.

---

[14] Therefore, this Court need not consider whether, in some other factual context, the *Pike County* analysis would be valid.

II. THE STATE ACTION HERE IN ISSUE ALSO VIOLATES THE COMMERCE CLAUSE

1. Preemption issues most commonly arise in a statutory context, where the question is whether a particular federal statute or regulation is intended to preempt state action. See, *e.g.*, *Pacific Gas & Electric Co.* v. *Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983). This case is somewhat unusual in that it also involves the closely related, but independent, question whether North Carolina's action is repugnant to the Commerce Clause itself.

We submit that the state's action here, designed to further narrow parochial interests, is precisely the sort of regulation the Framers wished to remove from the control of the individual states in reserving to Congress the power "[t]o regulate Commerce * * * among the several States" (Art. I, § 8, Cl. 3).

In altering the allocations of entitlement power established by FERC, NCUC has attempted to establish a system that will be more favorable to the local ratepayers. See *State ex rel. Utilities Commission* v. *Edmisten*, 299 N.C. 432, 434, 263 S.E.2d 583, 586 (1980) (directing NCUC, at an earlier stage in this proceeding, to consider whether reallocation of power "would be in the best interests of the customers of Nantahala"). It is understandable that North Carolina wants lower prices for its residents. But there is only a limited amount of the inexpensive entitlement power available, and it is not enough to satisfy the needs of customers in both North Carolina and Tennessee—Nantahala and Alcoa. In this situation, the Tennessee interests (see note 8, *supra*) are entitled to a decisionmaker with a less parochial perspective than NCUC. Not only the Federal Power

Act, but also the Commerce Clause, gives them that right.

This Court has recognized that in granting power over interstate commerce to Congress, rather than simply leaving all power over commerce to the states, "[t]he Commerce Clause was designed 'to avoid the tendencies toward economic Balkanization that had plagued relations among the colonies and later among the States and under the Articles of Confederation.'" *South-Central Timber Development, Inc.* v. *Wunnicke*, No. 82-1608 (May 22, 1984), slip op. 9, quoting from *Hughes* v. *Oklahoma*, 441 U.S. 322, 325 (1979). More specifically, as this Court explained in an analogous context in *New England Power Co.* v. *New Hampshire*, 455 U.S. at 338-339 (citations omitted): "[o]ur cases consistently have held that the Commerce Clause * * * precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to the products derived therefrom." That principle invalidated the attempt of the New Hampshire utility commission in that case "to gain an economic advantage for New Hampshire citizens at the expense of [the utility's] customers in neighboring states" by requiring the utility, as a condition of sending power out of the state, to sell an equivalent amount of electricity to New Hampshire customers at rates reflecting the low costs of producing hydro-electric power within the state. By the same reasoning, the Commerce Clause does not permit NCUC to allocate the entitlement power produced in both North Carolina and Tennessee so as to gain a preferential economic benefit for North Carolina citizens. In either case, "[s]uch state-imposed burdens cannot be squared with the Commerce Clause

when they serve only to advance 'simple economic protectionism.'" 455 U.S. at 339 (quoting *City of Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978)).[15] Accord, *Middle South Energy, Inc.* v. *Arkansas Public Service Comm'n*, 772 F.2d 404, 416-417 (8th Cir. 1985) (recognizing that cost shifting similar to that at issue here is invalid under *New England Power*).[16]

2. If, contrary to our submissions, the Court were to conclude that the NCUC action affirmed by the court below was neither preempted by the Federal Power Act nor invalid as economic protectionism prohibited by the Commerce Clause, the question would remain whether the state action here by its very nature extends into an area forbidden to the states under the Commerce Clause. This is scarcely a new

---

[15] "Economic protectionism" may be found on the basis of either discriminatory purpose or discriminatory effect. *Bacchus Imports, Ltd.* v. *Dias*, No. 82-1565 (June 29, 1984), slip op. 6; *City of Philadelphia* v. *New Jersey*, 437 U.S. at 626. The NCUC action is invalid under either standard.

[16] The court below incorrectly concluded (J.S. App. 104a) that this Court held in *Arkansas Electric Cooperative Corp.*, that the traditional rate making functions of state public service commissions can never amount to economic protectionism. Instead, the Court simply held that in that case, where the local interests obviously dominated, economic protectionism was not involved. 461 U.S. at 394, 381.

The reliance of the court below (J.S. App. 105a) on this Court's remark in *Arkansas Electric Cooperative Corp.*, 461 U.S. at 395, that "the national fabric does not seem to have been seriously disturbed by leaving regulation of retail utility rates largely to the States" is also misplaced. As we have shown (page 12, *supra*), the working system to which the Court referred includes the requirement that states in setting retail rates will recognize the federal determinations embedded in earlier stages of operations—*i.e.*, the "filed rate" principle.

problem. Indeed, it was precisely in order to resolve the "dilemma" of "[m]aintaining the proper balance between federal and state authority in the regulation of * * * energy utilities" that the Federal Power Act was enacted. *Arkansas Electric Cooperative Corp.*, 461 U.S. at 376-379. That Act was designed to "fill the gap" created by the decision in *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, *supra*, that the states lacked power to regulate electric utility transactions that imposed a direct, rather than an indirect, burden on interstate commerce (*Arkansas Electric Cooperative Corp.*, 461 U.S. at 379). If that "gap" were not entirely closed, so that, despite the Federal Power Act, there remained some area in which the states may enact regulations that impose a substantial burden on interstate commerce,[17] the courts would have to review each instance of such attempted regulation to determine whether it constituted even-handed, nondiscriminatory regulation. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *City of Philadelphia* v. *New Jersey*, 437 U.S. at 624; *Hughes* v. *Oklahoma*, 441 U.S. 322, 331 (1979); *Lewis* v. *BT Investment Managers, Inc.*, 447 U.S. 27, 36 (1980).

This approach would pose very difficult, if not intractable, problems not only for the courts, but also

[17] Although this Court's pre-*Attleboro* decisions drew a bright line of demarcation between interstate and intrastate commerce where the power entered the local distribution system, more recent cases have found that line more difficult to draw, in light of modern Commerce Clause jurisprudence. See *FERC* v. *Mississippi*, 456 U.S. 742, 757 (1982); *Arkansas Electric Cooperative Corp.*, 461 U.S. at 390-393. The difficulty is only exacerbated by the modern structure of the power industry, with an interconnected national grid involving constant transfers of power across state lines. See page 2, *supra*.

for the utilities involved, since, as we have explained (pages 18-19, *supra*), a utility serving customers in a number of states might find itself subject to a number of state regulatory decisions, each one "reasonable" in itself, but taken together having the net effect of denying the utility a fair return. See *Massachusetts* v. *United States*, 729 F.2d 886, 888 (1st Cir. 1984). There is, for the reasons explained above, no need for this Court to embark on that path in this case. The state utility commission is attempting to obtain for Nantahala's North Carolina customers the economic benefits of cheap power allocated to Tapoco's Tennessee customer under bulk power agreements subject to the undisputed jurisdiction of FERC. That attempt clearly infringes upon the authority reserved to FERC under the Federal Power Act, and seeks to impose an impermissible burden on interstate commerce under this Court's pre-Act Commerce Clause cases.

CONCLUSION

The judgment of the Supreme Court of North Caroline should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOANNE LEVEQUE
Attorney
Federal Energy Regulatory Commission

JANUARY 1986

☆ U. S. GOVERNMENT PRINTING OFFICE: 1986 491507 20138